

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PALM DEVELOPMENT co.)

Appearances:

For Appellant: Nathan Schwartz
Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Palm Development Co. against a proposed assessment of additional franchise tax in the amount of \$1,012.71 for the taxable year ended February 28, 1962.

The issue presented by this appeal is whether the income of a "commencing" corporation for the year in which it dissolved and transferred its assets to appellant, which held all of the stock of the commencing corporation, is includible in the measure of a franchise tax on appellant as well as in the measure of a franchise tax on the commencing corporation.

This opinion will be more readily understood if prefaced by a general description of the statutory plan which is the background of this appeal.

The franchise tax, which is imposed for the privilege of exercising a corporate franchise, is payable for and at the beginning of a taxable year measured by income of the preceding year. To launch this prepayment plan, a commencing corporation is normally required to pay at the beginning of

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its second year taxes for both its first and second years measured by income of the first year. . Thereafter, it pays a tax for each year measured by income of the preceding year.

If the corporation is dissolved in the course of a later year, its tax for that year is reduced, being measured by a fraction of the preceding year's income based on the number of months that it did business in its last year. None of the income of the final year is included in the measure of a tax. But if the corporation is dissolved pursuant to a 'reorganization, as where it transfe-rs its assets *or* business to a corporation controlled by the same interests, there is no reduction of tax for the final year and the income of the final year is included in **the** measure of a tax on the transferee for the following year.

The law provides for special treatment of a corporation which has not done business for 12 months in any of its taxable years. Until such time as a commencing corporation does business for a full 12 months in a taxable year, its tax for each year is measured by income of the **same** year rather than by income of the preceding year.

The case before us concerns the dissolution of such a commencing corporation in its second year, accompanied by the transfer of all of its assets to its parent corporation. We are required to determine whether the income of the commencing corporation for the year of its dissolution, income which is concededly includible in the measure of tax on the commencing corporation, is also includible in the--measure of *tax on* the transferee. The problem is one of relating statutory provisions specifical-ly covering commencing corporations with statutory provisions specifically covering reorganizations.

Appellant began business in California in 1958. It adopted a fiscal. year ending February 28. In 1960 it acquired all of the stock of Logan Development Co.

Logan Development Co. was incorporated and commenced business in California on November 2, 1959. It adopted a fiscal year ending June 30. For its first short taxable year of November 2, 1959, to June 30, 1960, Logan was subject to a franchise tax measured by the income of that year. (Rev. & Tax. Code, § 23222,)

On November 10, 1960, Logan was dissolved and all of its assets were transferred to appellant. Since Logan was a_ commencing corporation which did business for less than 12 months in its second taxable year (July 1, 1960, to November 10, 1960), Logan was subject to a franchise tax for that year measured by its income for that year. (Rev. & Tax. Code, § 23222a.)

Respondent Franchise Tax Board does not question the correctness of the taxes paid by Logan. On the ground that the transfer of assets called into play the reorganization provisions hereafter described, however, respondent also included Logan's income for the period July 1, 1960, to November 10, 1960, in the measure of appellant's franchise tax for its taxable year ended February 28, 1962. Appellant contends that none of Logan's income is includible in the measure of appellant's tax. We have concluded that appellant is correct.

Respondent states that the purpose of the reorganization provisions is to prevent tax avoidance through the shifting of assets between corporations where the control and ownership of the assets remain unchanged. The provisions were designed, argues respondent; to achieve the same tax consequences that would have resulted had a reorganization not occurred..

The method of taxation proposed by respondent, however, would not achieve but would only approach achieving the same tax consequences that would have resulted in the absence of a reorganization. If Logan had continued in business without reorganization and dissolution, all of the income from its business for the year ended June 30, 1961, would have been includible in the measure of Logan's tax for that year and the same income would have been includible in the measure of its tax for the year ended June 30, 1962. (Rev. & Tax. Code, § 23222a.) Under respondent's proposed method, only the income for the period July 1, 1960, to November 10, 1960, would be includible in the measure of two separate taxes. The degree of the disc-repancy between the tax results achieved by respondent's method and the tax results that would be 'Achieved in the absence of a reorganization and dissolution would vary with the timing of the reorganization and dissolution, with differences in the taxable years of the transferor and transferee, and with differences in the amounts of income de-rived before and after the reorganization and dissolution.

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We **do** not believe that the particular problem before us may be resolved adequately by reference solely to the broad, general purpose of the reorganization provisions. Our examination of those provisions indicates to us that they are not adaptable to, and were not intended to apply to, the case of a commencing corporation such as Logan, which dissolves in the course of a taxable year, even though it transfers its assets to another corporation pursuant to what would otherwise be a transaction covered by the reorganization provisions;

Section 23222a of the Revenue and Taxation Code provides that until a, commencing corporation does -business for 12 months in a taxable year its tax for each year is to be measured by the income of that year and that "In the event that a taxpayer is dissolved ... while subject to the provisions of this section, its tax for the year of dissolution . . . shall be measured by its net income for such year." It is undisputed that the tax on Logan for the year of its dissolution was properly measured by its income for that year, in accordance with this section,

The reorganization provisions are in sections 23251 through 23254. Section 23253, subdivision (a), contains the requirement that income of the transferor for the year of the reorganization be included in the measure of the transferee's tax for the next year. The section provides in part that "Gain of the transferor so included in the measure of the tax on the transferee shall be considered the income of the transferee for the purposes of Chapter 2." Chapter 2 includes section 23222a, the commencing corporation provision under which the gain or income in question was considered the income of the transferor, Logan, and which required that the income be included in the measure of Logan's tax. The reorganization provisions, therefore, are not amenable to integrated operation with the commencing corporation provisions.

Section 23254 also points toward the conclusion that the reorganization provisions do not apply in the case of a transferor covered by the commencing corporation provisions. That section states that "Where income of the transferor is required to be included in the computation of a tax on the transferee, such income shall not thereafter be included in the measure of a tax on the transferor." This section fairly indicates that the same income was not intended to be included in the measure of a tax on the transferee and also on the transferor.

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We must conclude that the method of taxation proposed by respondent is **not** permitted by the existing statutes.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Palm Development Co. against a proposed assessment of additional franchise-tax in the amount of \$1,012.71 for the taxable year ended February 28, 1962, be and the same is hereby reversed.

Done at Sacramento, California, this 15th day of December, 1966, by the State Board of Equalization.

_____, Chairman
Paul R. Legke, Member
John W. Lynch, Member
Robert E. Miller, Member
_____, Member

ATTEST: _____

Secretary